

**Letter of Findings: 01-20221024
Individual Income Tax
For the Year 2018 and 2019**

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Indiana Individual was unable to establish that the Department erred in assessing him additional individual income tax on pass-through income from his S corporation; Individual failed to refute the Department's disallowance of the S corporation's business expenses because the expenses were either not "ordinary and necessary" or were not adequately documented.

ISSUE

I. Individual Income Tax - Business Expenses and Flow-Through Income.

Authority: IC § 6-3-1-3.5; IC § 6-3-6-10; IC § 6-8.1-5-1; IC § 6-8.1-5-4; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Treas. Reg. § 1.162-1; [45 IAC 3.1-1-1](#); [45 IAC 15-5-1](#); *Publication 463; Travel, Gift, and Car Expenses*, <https://www.irs.gov/pub/irs-pdf/p463.pdf>.

Taxpayer argues that the assessment of additional individual income tax is unwarranted because the Department's audit overstated the amount of income flowing through from his S corporation.

STATEMENT OF FACTS

Taxpayer is an Indiana resident and the sole owner of an S corporation. The S corporation is in the business of selling lighting fixtures. The Indiana Department of Revenue ("Department") conducted an audit review of both the S corporation and Taxpayer's business records and tax returns.

The Department determined that the S corporation erred in reporting the amount of income which flowed through to Taxpayer. The errors consisted of purportedly claiming unwarranted or undocumented business expense deductions. When several of the S corporation's business deductions were disallowed, the amount of taxable income increased. These various adjustments resulted in an assessment of individual income tax.

Taxpayer disagreed with the assessment of individual income tax and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer explained the basis for his protest. This Letter of Findings results.

Despite the fact that Taxpayer is protesting an assessment of individual income tax, this Letter of Findings necessarily addresses issues and questions attributable to the S corporation.

I. Individual Income Tax - Business Expenses and Flow-Through Income.

DISCUSSION

The issue is whether Taxpayer has met his burden of establishing that the business expenses claimed by his S corporation were correct, that the Department erred in disallowing a portion of these expenses, and that the assessment of additional individual income tax was wrong.

A. Burden of Proof.

As a threshold issue, it is the Taxpayer's responsibility to establish that the income tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

In making his or her case, a taxpayer is required to provide documentation explaining and supporting his or her argument that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

B. Travel, Vehicle, and Related Expenses.

IC § 6-3-1-3.5 states as follows: "When used in [IC 6-3](#), the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined in 62 of the Internal Revenue)" The Department's regulation restates the principal. [45 IAC 3.1-1-1](#) defines individual adjusted gross income as follows:

Adjusted Gross Income for Individuals Defined. For individuals, "Adjusted Gross Income" is Adjusted Gross Income as defined in Internal Revenue Code § 62 modified as follows:

- (1) Begin with gross income as defined in section 61 of the Internal Revenue Code
- (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code
- (3) Make all modifications required by [IC 6-3-1-3.5\(a\)](#).

Under Treas. Reg. § 1.162-1, a taxpayer, whether a corporation, an individual, partnership, or a trust or estate, generally may deduct from its gross income the ordinary and necessary expenses of carrying on a trade or business that are paid or incurred during the tax year.

Taxpayer owns a motor home and a SUV used to travel from place to place demonstrating and selling the S corporation's lighting fixtures. The S corporation originally claimed travel, gift, vehicle, fuel, restaurant meals as business expenses. The audit questioned whether or not particular expenses such as cruise ship expenses, trips to national parks, trips to Disneyland, or car detailing, were "ordinary and necessary." The audit also questioned whether all hotel and meal expenses constituted "business" expenses. As pointed out in the audit report:

Per IRS Publication 463 you can deduct the cost of meals if it is necessary to stop for substantial sleep or rest to perform your duties while traveling away from home on business, but you can only deduct fifty percent [] of the cost of meals.

C. Record and Documentation Requirements.

The Department's audit requested copies of travel logs, mileage logs, but - according to the audit report - "[t]he auditor did not receive the necessary records from the [T]axpayer to show that these expense[s] are ordinary business expenses." However, the audit agreed as here explained:

[T]he auditor agrees that the [T]axpayer will travel to customer job sites and occasionally need to stay overnight to perform the work. The mileage to all job sites, as well as hotels and meals for overnight business travel would be classified as ordinary and necessary business expenses.

As to S corporation's record and documentation obligations, Indiana law provides "[e]very person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for tax by reviewing those books and records." IC § 6-8.1-5-4(a). In addition, IC § 6-8.1-5-4(c) provides that, "A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times."

Specifically, IC § 6-3-6-10(a) provides:

A taxpayer subject to taxation under this article shall keep and preserve records and any other books or accounts as required by [IC 6-8.1-5-4](#). All the records shall be kept open for examination at any time by the department or its authorized agents. A taxpayer who violates this subsection or fails to comply with the request of the department pursuant to [IC 6-3-4-6](#) commits a Class A misdemeanor.

The Department's audit made reference to IRS Publication 463 which provides useful guidance on a taxpayer's record-keeping obligations:

You should keep adequate records to prove your expenses or have sufficient evidence that will support your own statement. You must generally prepare a written record for it to be considered adequate. This is because written evidence is more reliable than oral evidence alone. However, if you prepare a record on a computer, it is considered an adequate record.

....

You should keep the proof you need in an account book, diary, log, statement of expense, trip sheets, or similar record. You should also keep documentary evidence that, together with your record, will support each element of an expense.

....

Documentary evidence will ordinarily be considered adequate if it shows the amount, date, place, and essential character of the expense. *Publication 463; Travel, Gift, and Car Expenses*, available at <https://www.irs.gov/pub/irs-pdf/p463.pdf> (Last visited March 25, 2022).

D. Audit Conclusions.

Based on the fact that Taxpayer claimed expenses that did not seem to qualify as "ordinary and necessary" business expenses, that Taxpayer failed to maintain complete mileage or travel logs, overstated the amount of office expenses, and was unable to distinguish between personal expenses, the audit exercised its authority to assess additional tax as provided under IC § 6-8.1-5-1(a) which states that "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available." See also [45 IAC 15-5-1](#).

E. Taxpayer's Response and the Department's Conclusion.

Taxpayer maintains that the Department disallowed 100 percent of office expenses, nearly 75 percent of the travel expenses, and more than 90 percent of his meal expenses. Taxpayer explains that he is "rarely in my home office" but is regularly "running errands" and conducting business. Taxpayer argues that even on trips to Disneyland and national parks, he is conducting business. Taxpayer further explains that although he takes "personal vacations and weekend adventures" every one of the vacations and adventures is "tied into a business trip." According to Taxpayer "[e]verywhere I go I must work a full day answering phone calls and meeting with people."

The Department has no reason to question Taxpayer's business practices and is no position to tell Taxpayer how or where to conduct his business. However, even if the Department were to accept each and every one of Taxpayer's numerous objections as valid arguments, the simple fact is that Taxpayer does not have specific, contemporaneous documentation that would refute any of the audit's adjustments. As a result, Taxpayer has not met his burden of establishing that the assessment was wrong as required under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

March 30, 2022

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